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In the Supreme Court of the United States

OCTOBER TERM 1976

No. 76-973

STATE OF ARIZONA, et al.,
Petitioners,

v.

COOK PAINT AND VARNISH COMPANY, et al.,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals For the Ninth Circuit

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No. .....

STATE OF ARIZONA, et al.,
Petitioners,

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COOK PAINT AND VARNISH COMPANY, et al.,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals For the Ninth Circuit

The petitioners State of Arizona, et al.* respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on August 20, 1976.

*Automatic Welding and Supply Corporation, Briggs Lemon Association, C.W.R. Citrus Processors, Inc., Exeter Citrus Association, Mupu Citrus Association, Saticoy Lemon Association, Sunmac Hawaii, Ltd., Sun Country Citrus, Inc., Wood Lake Packing House, Yerba Corporation, Yuma Citrus Exchange. Respondents, defendants below (hereinafter "defendants"), are Cook Paint and Varnish Company, The Flintoke Company, PPG Industries, Inc., Reichhold Chemicals, Inc., and Upjohn Company.

OPINION BELOW

The opinion of the Court of Appeals, not yet reported, appears in the Appendix hereto. The opinion of the District Court for the District of Arizona is reported at 391 F. Supp. 962 (D.Ariz. 1975) and is also included in the Appendix.

JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit was entered on August 20, 1976. A timely petition for rehearing in banc was denied on October 15, 1976, and this petition for certiorari was filed within 90 days after that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

I. Is a conspiracy among manufacturers not to compete with one another on the basis of the relative qualities of their individual products, which had as one of its effects the maintenance of prices at artificially high levels, in restraint of trade within the meaning of Section 1 of the Sherman Act?

A. Does Section 1 of the Sherman Act require an "actual purpose" to restrain trade when the conspiracy is aimed at the marketplace and the restraint in fact occurs?

B. May petitioners' complaint be dismissed under Rule 12(b)(6) of the Federal Rules of Civil Procedure based on a factual assumption contrary to the pleading and contrary to the only evidence in the record?

II. A. In Counts Two and Three of their complaint, petitioners allege that defendants' tortious conduct and defective products caused "physical harm" to their buildings. Petitioners here assert that the courts below rejected this

well-pleaded fact, which was an essential part of "a short and plain statement of the claim showing that the pleader is entitled to relief", and also assert that the courts below dismissed petitioners' complaint for failure "to state a claim upon which relief can be granted" by making an opposing finding of fact which was without affidavit or evidential support.

If petitioners' assertions are well taken, did the lower courts reject the purpose and meaning of Rules 8(a)(2) and 12(b)(6), Federal Rules of Civil Procedure, by departing from the accepted and usual course of federal judicial pretrial proceedings and in disregard of the decisions of this Court?

B. If Petitioners' complaint conforms to the requirements of Rule 8(a)(2), and if the lower courts erred in granting a Rule 12(b)(6) dismissal of petitioners' complaint, are the judgments below in conflict with an important rule of substantive law of four states?

STATUTORY PROVISIONS INVOLVED

United States Code, Title 15:

Section 1. Trusts, etc., in restraint of trade illegal; penalty

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal ....

STATEMENT OF THE CASE

I. Antitrust Count.

Petitioners brought this action in the District Court for the District of Arizona. By Count One of their complaint petitioners sought treble damages for violation of Section 1 of the Sherman Act, 15 U.S.C. § 1, and jurisdiction of the court was based on Section 4 of the Clayton Act, 15 U.S.C. § 15.

Beginning in the early 1960s the defendants represented to purchasers of their polyurethane foam insulation products and the public generally that such products were as free from the hazards of fire as other more conventional insulation products. These representations were made in concert with and under the auspices of trade associations and testing organizations such as The Society of the Plastics Industry, Inc., The American Society for Testing and Materials, and Underwriters Laboratories, Inc. Petitioners allege defendants knew these representations were not true. R. 11, 31, 353-55.

The defendants tested their products for flammability characteristics by using several small-scale laboratory tests. On the basis of these laboratory results, defendants' products were variously described as "non-burning", "self-extinguishing", "slow-burning" and "fire retardant". These test labels were used by the defendants in marketing their products. R. 27-28, 353-55.

By the mid-1960s the defendants knew that the small-scale laboratory tests had severe limitations. Although their products, under specific test procedures and prescribed laboratory conditions, qualified as "non-burning" or "self-extinguishing", defendants knew from the very nature of the tests and from experience that, under actual fire conditions inside buildings, the test result labels were misleading; that their products could burn with "explosive" rapidity and were extremely dangerous to life and property. R. 28, 354.

Recognizing the market implications of revealing the true flammability characteristics of their products, the defendants, through their trade association, The Society of the Plastics Industry, Inc., and otherwise, agreed to conceal from consumers the inadequacy and misleading features of

the smale-scale tests. Pursuant to this concerted action, they marketed their insulation products by continuing to exploit the labels "non-burning", "self-extinguishing", or "slow-burning", knowing these terms were inaccurate and misleading.

Absent this conspiracy, defendants would have been free to compete with one another on the basis of their individual products' relative freedom from flammability hazard. Polyurethane foam insulation has sold at artificially high prices. Had consumers been aware of the true flammability characteristics of polyurethane foam, as they should have been in a free, open and competitive market, the price of polyurethane insulation would have been lower. Competition among the defendants to research and develop safer polyurethane foam products and to use reliable tests of flammability was suppressed. The ability of manufacturers and sellers of insulation products made of materials other than polyurethane foam, such as asbestos and fiberglass, to compete with the defendants was reduced and suppressed. Finally, consumers were deprived of the opportunity to purchase polyurethane foam products in an open and competitive market. The district court dismissed for the reason that there appeared to be only a "constructive" as opposed to "actual" purpose to restrain trade. The court of appeals affirmed.

II. State Law Counts.

In Counts Two and Three of their complaint, based on theories of strict liability in tort and negligence, petitioners sought damages from defendants for the physical harm caused to their buildings by the application of defendants' insulation products onto their walls and ceilings. The district court's jurisdiction over the state law claims was based on the doctrine of pendent jurisdiction.

In addition to alleging the fact that defendants' defective products caused "physical harm" to their buildings, petitioners also alleged that defendants' insulation products, when spray plastered onto the walls and ceilings of petitioners' buildings, became such an integral part of those buildings that it has been or will be necessary either to tear the insulation from the building surfaces, causing additional damage, or to alter the buildings to enable them to structurally support an additional layer of portland cement plaster or some other heavy fireproof material to be applied over the highly flammable insulation. R. 356. This integration, according to petitioners' complaint, altered the physical shape and appearance of the buildings.

Petitioners further alleged some of the damages which they suffered as the result of the physical harm to their buildings, asserting that the safe use and occupancy of the buildings have been prevented; local authorities have wholly prohibited the use and occupancy of some buildings; petitioners cannot carry on normal activities involving heat, sparks or flame because of the extreme fire danger; the buildings have become veritable firetraps; their market value has been diminished, their marketability impaired; and that large sums of money have been expended or will be expended to make the buildings reasonably fire safe and tenantable.

The district court dismissed all three counts of petitioner's complaint for failure to state claims upon which relief can be granted. The court of appeals, without discussing the merits of the claims, affirmed the dismissal of all three counts "for the reasons stated" by the district court.

REASONS FOR GRANTING THE WRIT

I. The Decision Below (1) Seriously Erodes the Scope of Section 1 of the Sherman Act, (2) Conflicts with the Decisions of This Court and Other Courts of Appeals, and (3) Is Based on a Factual Assumption Outside the Record in Complete Disregard of Rule 12(b)(6) of the Federal Rules of Civil Procedure.

The decision of the courts below represents a serious erosion of the breadth of the Sherman Act as it has been applied to price fixing conspiracies in such cases as *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 60 S. Ct. 811, 84 L. Ed. 1129 (1940), and *United States v. Container Corporation of America*, 393 U.S. 333, 89 S. Ct. 510, 21 L. Ed. 2d 526 (1969). If the decision below is allowed to stand, there will be a new "actual purpose" doctrine imported into Section 1 of the Sherman Act. This is unwarranted and unsupported. It not only denies petitioners a remedy, but will restrict the usefulness of the Sherman Act in thwarting sophisticated economic conspiracies such as the one here involved.

United States v. Socony-Vacuum Oil Co., supra, firmly established that concerted action among competitors affecting the price of their product by reducing, inhibiting, or interfering with the interplay of market forces, is illegal. This Court's opinion clearly articulated its view of conspiracies and combinations tampering with price:

> Any combination which tampers with price structures is engaged in an unlawful activity. Even though the members of the price-fixing group were in no position to control the market, to the extent that they raised, lowered, or stabilized prices they would be directly interfering with the free play of market forces. The Act places all such schemes beyond the pale and protects that vital part of our economy against any degree of interference.

310 U.S. at 221.

The conspiracy in this case falls squarely within the scope of conduct this Court declared unlawful under Section 1 of the Sherman Act in *Socony-Vacuum*. In that case, the defendants' concerted action in purchasing gasoline on the spot market was intended ultimately to affect their own tank car prices by manipulating a factor of the marketplace—supply. Defendants' concerted action in this case in concealing and misrepresenting their products' flammability characteristics was just as surely aimed at manipulating a factor of the marketplace — quality information — which affected their products' price. The defendants' uniform representations and promotional practices deprived the marketplace of a "factor [used] in determining . . . going prices," and thus restricted competition by inhibiting and reducing "the play of the forces of supply and demand." 310 U.S. at 220.

Since *Socony-Vacuum*, it has become well established that an agreement among competitors tampering with or otherwise affecting price, even though not directly fixing a price, constitutes a per se violation of Section 1. *See, e.g., National Macaroni Manufacturers' Association v. FTC*, 345 F.2d 421 (7th Cir. 1965); *United States v. Gasoline Retailers' Association*, 285 F.2d 688 (7th Cir. 1961); *Plymouth Dealers' Association v. United States*, 279 F.2d 128 (9th Cir. 1960).

The defendants' conspiracy is a price fixing conspiracy, albeit perhaps an unusual one, one which grew out of the unusual situation facing the defendants in the 1960s: They discovered that the product for which they had anticipated a tremendous potential market, a potential they had already begun to realize, was unsafe for the very purpose for which it was intended. To avoid the effect this knowledge would have on a free, open and competitive market, the defendants combined to conceal their knowledge from purchasers

and the consuming public and to misrepresent the flammability characteristics of their products. Without question, the *purpose* of this conspiracy was to interfere with a free market, and to deprive consumers of the benefits of free and open competition. *See Apex Hosiery Co. v. Leader*, 310 U.S. 469, 60 S. Ct. 982, 84 L. Ed. 1311 (1940).* The district court analogized the facts in *Apex* to the facts here. There is, however, a significant distinction: In *Apex* the conspiracy was not aimed at the marketplace. But it is clear from the *Apex* opinion that where the conspiracy either "is *shown to have* or is intended to have an *effect upon prices in the market or otherwise to deprive purchasers or consumers of the advantages which they derive from free competition*", 310 U.S. at 501 (emphasis added), the Sherman Act is violated. The conspiracy here was clearly aimed at the marketplace, had an effect upon prices and otherwise deprived purchasers or consumers of the advantages which they derive from free competition.

The defendants' intent to interfere with the forces of a free market, coupled with the adverse effects of their conduct on those forces, is a violation of the Sherman Act. *See United States v. American Linseed Oil Co.*, 262 U.S. 371, 43 S. Ct. 607, 67 L. Ed. 1035 (1923); *see also United States v. Container Corporation of America, supra; Apex Hosiery Co. v. Leader, supra; United States v. Socony-Vacuum Oil Co., supra.* The defendants' conspiracy had nothing less than a pernicious effect on competition and it clearly lacks any redeeming virtue. As such, it must be conclusively presumed to be unreasonable and therefore a per se violation.

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*_Apex_ concerned a strike by a labor union that resulted in the destruction of equipment and other plant property and a delay of hosiery shipments in interstate commerce. This Court noted that "[s]o far as appears the delay of these shipments *was not intended to have and had no effect on prices* of hosiery in the market . . . ." 310 U.S. at 501 (emphasis added).

The courts below ignored the precedents established and the guidance provided by this Court and set forth a new test for determining what is a conspiracy in restraint of trade under the Sherman Act. The district court based its ruling (adopted by the court of appeals) upon a distinction between "actual" and "constructive" purposes to restrain trade. The court believed defendants' actual purpose was to deceive the public, and it was only their "constructive" purpose to restrain trade. The court held that an "actual", not just "constructive" purpose to restrain trade must accompany conduct challenged as in restraint of trade before the conduct can be held to violate the Sherman Act. No authority is cited for this important, indeed revolutionary, distinction.

The Sherman Act makes illegal "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states. . . ." 15 U.S.C. § 1. If the combination or conspiracy restrains trade among the several states it is illegal. The *actual* purpose of many agreements held to violate Section 1 may not be to restrain trade, but they are nevertheless held illegal because they do in fact restrain trade.* To say that the Sherman Act does not apply because the constructive, but not actual, purpose is to restrain trade is to address the wrong issue. The question is whether the conspiracy is

*See, *United States v. Topco Associates, Inc.*, 405 U.S. 596, 92 S. Ct. 1126, 31 L. Ed. 2d 515 (1972); *Northern Pac. Ry. v. United States*, 356 U.S. 1, 78 S. Ct. 514, 2 L. Ed. 2d 545 (1958). The actual purpose of the challenged combination in *Topco* was to enhance competition between small or local and regional independent grocery chains and the larger national and regional chains marketing their own private brand products. The combination was struck down because it restrained trade among the combination's participants. This Court's analysis did not require an "actual" purpose: The combination was illegal because it restrained trade. The Sherman Act does not speak in terms of actual or constructive purposes, it speaks only in terms of restraints of trade.

aimed at the marketplace and in fact restrains trade. If the answer is yes, no further showing of purpose is required.

Although Congress may have intended to include within the meaning of the term "restraint of trade" those types of conduct held to restrain trade at common law, it also chose to rely on the federal courts to develop the scope and application of the term "restraint of trade". A narrow interpretation of the term was not intended. *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 76 S. Ct. 994, 100 L. Ed. 1264 (1956). *See also Apex Hosiery Co. v. Leader, supra; Standard Oil Co. v. United States*, 221 U.S. 1, 31 S. Ct. 502, 55 L. Ed. 619 (1911).

The decision of the district court followed what was treated as a motion to dismiss for failure to state a claim under Rule 12(b)(6) of the Federal Rules of Civil Procedure. Under that rule, petitioners were entitled to have their complaint judged only on the allegations in the pleadings, and not on the basis of factual assumptions for which no support is found in the record or the pleadings. The district court, however, assumed that "each of the defendants individually, with or without a conspiracy would have been required to conceal [the] flammability characteristics *in order to insure the survival of its product as a marketable* commodity." See p. 12 of Appendix hereto (391 F. Supp. at 969). Were this so, perhaps the district court's conclusion would be correct; at least it could be said that defendants might have behaved the way they did even in the absence of a conspiracy. But petitioners have never alleged and no evidence has ever been introduced suggesting that the disclosure of the flammability characteristics of defendants' products would have destroyed their marketability. To the contrary, petitioners introduced at a preliminary hearing a current brochure which extolled the

merits of defendant Upjohn's polyurethane insulation and included disclosure of the product's flammability hazard. R. 57. Contrary to the district court's (and the Ninth Circuit's) assumption, Upjohn has not been driven from the marketplace by reason of its disclosures. Furthermore, the assumed fact on which the district court relied is wholly without support in the record; the only evidence is to the contrary. For this reason the dismissal of petitioner's complaint under Rule 12(b)(6) was clearly erroneous. If this Court is to preserve the integrity of that rule, the decision must be reversed.

The district court's erroneous factual assumption resulted in a convolution of petitioners' argument. Following the above-quoted assumption, the district court continued: "The assertion, then, that absent the conspiracy the defendants would have competed to reveal the actual flammability characteristics of polyurethane insulation products and that the conspiracy thus suppressed competition among them is simply untenable." See p. 12 of Appendix hereto (391 F. Supp. at 969).

Petitioners have never argued that absent the conspiracy each of the defendants would have competed against one another to reveal the actual flammability characteristics of its own product by suggesting that it was *more* flammable than the products of the others. Rather, petitioners have argued that absent the conspiracy the defendants would have competed against one another by attempting to show how each of their individual products was *less* flammable than the products of the others. The former argument, as the district court suggested, is probably untenable; the latter states a claim for relief under Section 1 of the Sherman Act.

Competition among manufacturers of admittedly hazardous products on the basis of their individual products' relative freedom from the hazard, is not uncommon. For example, prior to the recognition of the health hazards associated with smoking and the mandatory disclosure of such hazards, cigarette manufacturers competed with one another largely on the basis of their products' taste and their ability to give smokers a sense of masculinity, sophistication, togetherness and the like. Today cigarette manufacturers candidly acknowledge, even beyond what is required by law, the hazardous potential of their products. As a large segment of the consuming public continues to smoke cigarettes, cigarette manufacturers are forced to compete against one another on the basis of their products' freedom from tar and nicotine and the efficiency of their filters. Those whose products contain larger quantities of tar and nicotine, stress other qualities.

A conspiracy among the manufacturers of cigarettes to misrepresent to the public that their products are free of health hazards (absent, of course, the mandatory disclosure law) and to eliminate all advertising* designed to promote competing brands on the basis of their relative freedom from those hazards would not differ from the conspiracy petitioners have alleged among the manufacturers of polyurethane insulation. Such an agreement, taking as it would from the consumer a vital ingredient in his choice among competing brands of cigarettes, would markedly suppress presently existing competition among the cigarette manufacturers. The agreement among the manufacturers of poly-

*Advertising is one of the principal means by which rival businesses compete for sales. Agreements restricting advertising competition have been held per se violations of the Sherman Act. *United States v. House of Seagram, Inc.*, 1965 Trade Cas. ¶ 71,517, at 81,269 (S. D. Fla. 1965). *See also United States v. Gasoline Retailers' Ass'n*, 285 F.2d 688 (7th Cir. 1961); *Louisiana Petroleum Retail Dealers, Inc. v. Texas Co.*, 148 F. Supp. 334 (W.D. La. 1956).

urethane insulation similarly took from the consumer a vital ingredient in his choice among competing brands of polyurethane insulation, and markedly suppressed competition that could have and would have existed among them.

In summary, the courts below have not only disregarded prior decisions of this Court and other courts of appeals, but have engrafted onto Section 1 of the Sherman Act a wholly unwarranted "actual purpose" test. A serious question of interpretation is presented which has wide-range importance and should be decided by this Court. Moreover, the courts below disregarded Rule 12(b)(6) by assuming a fact which was contrary to the plaintiffs' pleading and contrary to the only evidence in the record. That aspect of the decision should be reviewed by this Court, not only to correct an erroneous result, but to make it clear that Rule 12(b)(6) may not be so abused.

Accordingly, *certiorari* should be granted.

II. (1) The Decision Below Disregards the Plain Meaning of Rules 8(a)(2) and 12(b)(6), Federal Rules of Civil Procedure, and Is in Conflict with the Decisions of This Court.

Count Two of petitioners' complaint was based on strict liability in tort, Count Three on negligence. The state law applicable to the claims asserted in these two counts was agreed by the parties and recognized by the district court to be the doctrines of strict liability in tort and negligence as enunciated in Section 402A ("Special Liability of Seller of Product for Physical Harm to User or Consumer") and Section 395 ("Negligent Manufacture of Chattel Dangerous Unless Carefully Made") of the RESTATEMENT (SECOND) OF TORTS. See pp. 14-15 of Appendix hereto (391 F. Supp. at 971). On both RESTATEMENT theories, liability is predicated on "physical harm" caused to the "user or consumer or to his property".

Petitioners alleged as the essential elements of the claims founded on these two state law theories that defendants' products were negligently manufactured and dangerously

defective, and that they caused "physical harm" and damage to petitioners' buildings. These allegations were necessary to a proper statement of the claims and fully satisfied the requirement of Rule 8(a)(2), FED. R. CIV. P., of "a short and plain statement of the claim showing that the pleader is entitled to relief". Coupled with allegations of jurisdiction and a prayer for damages, these allegations were sufficient to repel a Rule 12(b)(6) motion for failure to state a claim upon which relief can be granted. (The complaint contained additional allegations specifying the nature of petitioners' losses and damages resulting from the physical harm to their buildings. See pages 18-19, *infra*.) Nevertheless, the district court granted three out of the five defendants' 12(b)(6) motion to dismiss Counts Two and Three of petitioners' complaint.*

In dismissing these two counts *with prejudice* and entering judgment for defendants, the district court necessarily *found as a fact* that the integration of defendants' insulation products into petitioners' buildings *did not cause physical harm to the buildings*.

In so ruling, the district court rejected the plain meaning and very purpose of Rules 8(a)(2) and 12(b)(6), FED. R. CIV. P. It rejected the constructions given those Rules by this Court, by the Ninth Circuit Court of Appeals and other courts of appeal.

The circuit court's three-judge panel, apparently preoccupied with a pointless diversity jurisdiction issue which was raised by the panel on its own motion at oral argument, affirmed the judgment of the district court in one sentence.**

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*These two counts were dismissed *without prejudice* as to defendants Reichhold Chemicals, Inc. and Cook Paint and Varnish Company. Count Four, a state law misrepresentation claim, was also dismissed *without prejudice* as to all five defendants.

**"The judgment is affirmed in all respects, for the reasons stated by District Judge Renfrew in his opinion [citation omitted]." See p. 19 of Appendix hereto.

This Court has often instructed that "a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief". *Conley v. Gibson,* 355 U.S. 41, 78 S. Ct. 99, 2 L. Ed. 2d 80 (1957); *see also Scheuer v. Rhodes,* 416 U.S. 232, 94 S. Ct. 1683, 40 L. Ed. 2d 90 (1974). In previous cases, the Ninth Circuit Court has followed and applied this direction. Its clear perception of the meaning and effect of these Rules appears in *Bodine Produce, Inc. v. United Farm Workers Organizing Committee,* 494 F.2d 541, 556 (9th Cir. 1974):

> A complaint is not subject to dismissal unless it appears to a certainty that no relief can be granted under any set of facts that can be proved in support of its allegations. This rule, which has been stated literally hundreds of times, precludes final dismissal for insufficiency of the complaint except in the extraordinary case where the pleader makes allegations that show on the face of the complaint some insuperable bar to relief. [Footnote omitted.]
>
> This tolerance with respect to claims for relief (as well as the correlative intolerance with respect to motions to dismiss) rests upon the principle that discovery and other pretrial procedures serve the purpose of more precise disclosure of the facts, thereby narrowing both the disputed facts and the issues left for trial.

The Ninth Circuit's disregard of this Court's decisions and its own raises once again a fundamental question under the Federal Rules of Civil Procedure:

> May the lesser federal courts elect not to apply Rule 12(b)(6) or must this Rule be evenly applied in all cases?

Petitioners alleged the *fact* that defendants' products *caused physical harm* to petitioners' buildings. In a Rule 12(b)(6) setting, this allegation of physical harm had to

be taken as true. The *fact of physical* harm was before the district court because *this fact was pleaded.* The district court's dismissal with prejudice, in the absence of any evidence and without giving petitioners an opportunity to prove that their buildings were physically harmed, was a clear rejection of this well-pleaded fact.

In finding as it did, that petitioners' buildings *were not physically harmed,* the district court abused its power. Such a finding could not be made on a Rule 12(b)(6) motion to dismiss, but only on a motion for summary judgment supported by affidavit, or after evidence had been introduced and a trial had occurred.

Dismissal of petitioners' complaint in these circumstances was a perversion of Rules 8(a)(2) and 12(b)(6), and the decisions of this Court construing them. Such an obvious departure from the accepted and usual course of judicial procedure under the Federal Rules calls for the exercise of this Court's power of supervision.

II. (2) The Decision Below Squarely Conflicts with the Applicable Law of Four States in the Important Area of Products Liability.

The district court and court of appeals have decided an important question of state products liability law. Their decisions are contrary to the law of each of the four states of which petitioners are citizens.* Given an opportunity,

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*The principle of strict liability in tort set out in Section 402A of the RESTATEMENT (SECOND) OF TORTS (1965) has been expressly adopted by Arizona (*Colvin v. Superior Equipment Co.,* 96 Ariz. 133, 392 P.2d 778 (1964); *Nalbandian v. Byron Jackson Pumps, Inc.,* 97 Ariz. 280, 399 P.2d 681 (1965); *O. S. Stapley Co. v. Miller,* 103 Ariz. 556, 447 P.2d 248 (1968)), California (*Vandermark v. Ford Motor Co.,* 61 Cal. 2d 256, 391 P.2d 168, 37 Cal. Rptr. 896 (1964), *Greenman v. Yuba Power Products, Inc.,* 59 Cal. 2d 57, 377 P.2d 897, 29 Cal. Rptr. 697 (1962)), and Hawaii (*Stewart v. Budget Rent-A-Car Corp.,* 52 Hawaii 71, 470 P.2d 240 (1970)). Alaska (*Clary v. Fifth Avenue Chrysler Center, Inc.,* 454 P.2d 244 (1969); *Butaud v. Suburban Marine & Sporting Goods, Inc.,* 543 P.2d 209 (1975)) has adopted an even broader strict liability rule.

the courts of those states would conclude that the plastering of an inch thick layer of defective and highly flammable insulation on all of the inner surfaces of a building would cause physical harm to that building.*

Petitioners alleged that the spray plastering of defendants' products on their walls and ceilings caused physical harm to petitioners' buildings and that they had "been physically altered or changed." Petitioners' complaint also alleged some of the kinds of damages which flowed from this physical alteration and harm:

> [1] The safe use and occupancy of Plaintiffs' buildings and structures have been unreasonably restricted or prevented in that Plaintiffs cannot carry on normal activities which require or involve heat, sparks or flame, because of the extreme danger of fire to their buildings ...

*Subsequent to the judgment of the district court, 10 of the present petitioners and numerous other plaintiffs filed actions in the state courts of Arizona and California. All plaintiffs asserted the negligence and strict liability claims here in issue, as well as claims based on misrepresentation (which, as to petitioners, the district court dismissed below without prejudice) and breach of express and implied warranties. Should the courts, as petitioners expect, decide the negligence and strict liability issues favorably to the other plaintiffs in those actions, the result will be highly prejudicial treatment of the present petitioners because of the *res judicata* effect of the lower courts' judgments.

Petitioners were before the district court on these two claims on the basis of pendent jurisdiction, Count One of their complaint having been based on Section 1 of the Sherman Act. Once that claim was dismissed, petitioners sought to avoid duplicate litigation and this potentially prejudicial result by moving both the district court and the court of appeals under the abstention doctrine to exercise their discretion and dismiss without prejudice all of the pendent state law claims. Count Four, a state law claim based on common law misrepresentation, was dismissed without prejudice by the district court as to all five defendants. The strict liability and negligence Counts Two and Three were also dismissed without prejudice, but only as to two out of the five defendants. The trial court proceedings were terminated in the early motion stage. No depositions were taken. No discovery on the merits or other trial preparations had begun.

> [2] Plaintiffs' buildings and structures have become incapable of reasonably safe habitation, use or occupancy
>
> [3] Plaintiffs' buildings and structures have become veritable firetraps and many of Plaintiffs are subject to orders or restrictions imposed by fire prevention or other local authorities limiting or wholly preventing the use and occupancy of their buildings and structures
>
> [4] In order to make their commercial buildings and structures reasonably fire safe, it will be necessary for Plaintiffs to physically sever or tear Defendants' product from the interior surfaces of their buildings and structures, which will necessarily result in additional physical harm and damage to said buildings and structures
>
> [5] The market value of Plaintiffs' buildings and structures has been diminished and their marketability impaired.

See pp. 13-14 of Appendix hereto (391 F. Supp. at 970).

The elemental error of the district court, which led it to reject the plain meaning of Rules 8(a)(2) and 12(b)(6), and to also misapply state law, was its failure to differentiate the fact of "damage" or "harm," on the one hand, and, on the other hand, the "damage*s*" which arise from such harm. Similarly, the district court failed to distinguish between an "injury" to property and the "losses" which are incurred by the owner of the property as the result of the injury.

The opinion of the district court has a facade of validity which vanishes if these verbal distinctions are made.

The district court's error is also revealed in its failure to correctly state the issue before it. The court quoted petitioners' allegations of the nature or type of damages

which they suffered as the result of the physical harm to their buildings. The district court said:

> Whether the *type of damage* described in plaintiffs' complaint, as set forth above, constitutes *physical harm to property* or instead some form of *"economic loss"* presents, therefore, the dispositive question here. Of the enumerated *injuries* only subparagraphs (a) and (c) even arguably involve *physical harm* to property. . . .

See p. 15 of Appendix hereto (391 F. Supp. at 971) (emphasis added).

The district court also said that

> [P]laintiffs have conceded that . . . the *types of injury* which are actionable under theories of strict liability and negligence *include physical harm* to property but *do not include* economic *loss,* loss of bargain, loss of profits and the like.

See pp. 14-15 of Appendix hereto (footnote omitted) (391 F. Supp. at 971) (emphasis added).

> With respect to the cases in the relevant states which apply these two doctrines, plaintiffs have conceded that they support the distinction between *physical harm* and *economic loss* . . . .

See p. 15 of Appendix hereto n. 10 (391 F. Supp. at 971) (emphasis added).

The district court thus confounded the terms "injury", "loss", "harm" and "damage". Petitioners did not make the concessions referred to. It would have been futile if they had done so. It is nonsensical to concede that the "types of injury" which are actionable "do not include economic loss". No "injury" *includes* a "loss". It is injury or physical harm which *causes* a loss. Moreover, petitioners' complaint is devoid of any claim for "loss of bargain, loss of profits and the like".

What petitioners did concede is that under RESTATEMENT Sections 395 and 402A, a negligently made or dangerously defective product must produce physical harm to some property, other than the product itself,* before the RESTATEMENT doctrines apply. Regardless of whether they are characterized as losses of bargain, economic losses or otherwise, such damages are not recoverable under the doctrines of strict liability in tort or negligence unless they flow from physical harm to property.

The district court recognized this rule and obviously concluded that the damages or losses alleged by petitioners** were "economic losses". The district court did not stop here. It went on to find that the plastering of a layer of defective insulation on the walls and ceilings of petitioners' buildings, which was integrated into and became a part of the buildings, and which cannot be removed except by further damaging and partially destroying the buildings, could not possibly have caused physical harm to the buildings.

In reaching this result, the district court ignored the Restatement definition of "physical harm". In a property context, the term "physical harm" is defined in comment *e* of RESTATEMENT (SECOND) OF TORTS, Section 7:

> e. *Physical harm.* The words "physical harm" are used to denote physical impairment . . . of tangible property . . . .

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*As indicated by the district court, the concession was "arguendo". See p. 15 of Appendix hereto, n. 10 (391 F. Supp. at 971). Several courts then had and many since have applied strict liability in situations where only the product was harmed or damaged.

**See pages 18-19, *supra.* The occupancy of some of petitioners' buildings has been condemned by local fire authorities. Other buildings which were in use and undamaged prior to the integration of defendants' products into them simply cannot be used for their intended purposes. Some of the buildings are either uninsurable or can be insured only at greatly increased rates. Numerous activities which normally occurred in the buildings prior to the damage caused by the application of the insulation cannot now be carried on.

The meaning of "physical impairment" appears in the discussion of the meaning of "harm" in this RESTATEMENT Section. According to the RESTATEMENT:

> The word "injury" is used throughout the Restatement of this Subject to denote the fact that there has been an invasion of a legally protected interest which, if it were the legal consequence of a tortious act, would entitle the person suffering the invasion to maintain an action of tort. It differs from the word "harm" in this: . . .
>
> . . . "Harm" implies a loss or detriment . . . *and not a mere change or alteration* in some physical person, object or thing. Physical changes or alterations may be either beneficial, detrimental, or of no consequence to a person. *In so far as physical changes have a detrimental effect on a person, that person suffers harm.* . . . Thus *harm*, as defined in this Section, *is the detriment or loss to a person which occurs by virtue of, or as a result of, some alteration or change in his person, or in physical things* . . . .

RESTATEMENT (SECOND) OF TORTS § 7, comments *a* and *b*, at 13 (1965) (emphasis added).

When defendants' defective products were integrated into petitioners' buildings, those buildings, as the complaint alleges, were "*physically altered or changed*". Those physical changes had a "detrimental effect" on the buildings and upon the petitioners who own them. The changes or alterations in the buildings have "physically impaired" the buildings. The integration of the defective products into petitioners' buildings was "detrimental". Petitioners' property has suffered "*physical harm*". Petitioners have incurred losses and damages as a direct result of that harm.

The usual definition of the word "physical" is "of or relating to natural or material things as opposed to things mental, moral, spiritual or imaginary". Ordinarily, the

word "harm" is defined as "injury", "hurt" or "damage". The courts below also ignored these common definitions.

In concluding that Counts Two and Three of petitioners' complaint failed to state a claim, the District Court relied principally on the dicta of *Seely v. White Motor Co.*, 63 Cal.2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965). Following an accident allegedly caused by a defect in a truck manufactured by the defendant, Seely brought an action based on breach of express warranty and strict liability in tort. The Supreme Court of California upheld the warranty judgment granting a partial refund of the purchase price and awarding plaintiff damages for lost profits.

The dicta of *Seely* dealt with plaintiff's claim that he was also entitled to recover under the doctrine of strict liability. The court pointed out that the recovery of "commercial losses" was confined to warranty claims and that there can be no recovery for such losses or "economic loss alone" on either a negligence or strict liability theory. The court then said:

> Plaintiff contends that, even though the law of warranty governs the economic relations between the parties, the doctrine of strict liability in tort should be extended to govern physical injury to plaintiff's property, as well as personal injury. We agree with this contention. . . . [Citing authorities, including RESTATEMENT Section 402A.] In this case, however, the trial court found that *there was no proof that the defect caused the physical damage* of the truck.

403 P.2d at 152 (emphasis added).

The obvious implication of this language is that if the mechanical "defect" in the truck which was found to exist had caused physical harm or injury to the truck itself, or to other property, recovery would have been permitted under both the theories of negligence and strict liability. The facts

which are presented in this petition and were before the courts below make the *Seely* dicta entirely inapposite. Unlike Mr. Seely, petitioners have alleged and can prove that defendants' defective insulation caused physical harm to their buildings. Unlike Mr. Seely, who sued for "lost profits and the refund of the money he paid on the truck", 403 P.2d at 150, petitioners are not concerned with lost profits and are unable to make a tender of the defective product to enable them to sue for rescission.

The district court, and the circuit court in affirming, rejected the holding of *Goodyear Rubber & Supply Co. v. Great American Insurance Co.*, 471 F.2d 1343 (9th Cir. 1973). *Goodyear* involved defective gasket material which was installed on the hatches of a ship. The issue was whether there was "damage to property other than the product defectively manufactured by Goodyear". 471 F.2d at 1344. The court held:

> Under well-settled principles, when one product is integrated into a larger entity and the product proves defective, the damage is considered as damage to the entity to the extent that the market value of the entity is reduced by an amount in excess of the value of the defective product.

Id.

The Ninth Circuit Court cited a number of cases supporting this principle and quoted approvingly the following language from *Hauenstein v. St. Paul-Mercury Indemnity Co.*, 242 Minn. 354, 65 N.W.2d 122, 125 (1954):

> "No one can reasonably contend that the application of a useless plaster, which has to be removed before the walls can be properly replastered, does not lower the market value of a building. Although the injury to the walls and ceilings can be rectified by removal of the defective plaster, nevertheless, *the presence of the*

> *defective plaster* on the walls and ceilings reduced the value of the building and *constituted property damage....*"

471 F.2d at 1345 (emphasis added).

If no one can reasonably contend that the application of *useless* plaster does not constitute "property damage", how could the courts below conclude, in the absence of evidence, that the application of *explosive* plaster could not cause physical harm? Petitioners' damages far exceed a mere reduction in market value of their buildings.

The result below is also inconsistent with other opinions of the Court of Appeals for the Ninth Circuit interpreting California and Arizona law. In *Bright v. Goodyear Tire & Rubber Co.*, 463 F.2d 240 (9th Cir. 1972), the court affirmed a district court judgment granting a Rule 12(b)(6) motion to dismiss a strict liability claim based on the assertion that tires purchased by the plaintiff were defective. By its dicta, the Ninth Circuit Court placed a construction upon *Seely* which is at complete odds with the construction below. This inconsistency appears on the face of the opinion:

> Appellant does not allege that ... his property was physically injured .... The California Supreme Court has indicated that such an allegation is essential to a tort cause of action. . . . [Discussing and quoting *Seely*.]
>
> Thus, the allegations contained in appellant's complaint place his cause of action in the warranty rather than the tort category under California law. He alleged that "defects" had occurred "in some or all of said 'polyglas' tires," but he did not allege that he had suffered any physical injury . . . to his property, other than the tires themselves, as a result of the defects.

The district court's reliance upon *Southwest Forest Industries, Inc. v. Westinghouse Electric Corp.*, 422 F.2d

1013 (9th Cir. 1970) is also misplaced. *Southwest* was an appeal from the District Court of Arizona. The district court below cited *Southwest* for the proposition that the theory of strict liability does not pertain to "mere possible consequential damage flowing from the failure of the product to meet expected standards of performance". See p. 17 of Appendix hereto n. 12 (391 F. Supp. at 972). Resultant consequential damages are not recoverable on this theory. Petitioners, of course, agree. They claim no such damages. The holding of *Southwest* under its facts is perfectly consistent with the law of Arizona as embodied in Section 402A of the RESTATEMENT. The damages sought in *Southwest* were for "lost time, labor, materials and loss of business". 422 F.2d at 1014. A turbine generator was installed at Southwest's papermill. It was a "highly specialized, custom-built piece of machinery, built to particular specifications and tested in the factory before delivery, under supervision of engineers representing both parties." 422 F.2d at 1020.

There was no allegation or even a suggestion that the claimed defect in the generator had caused physical harm either to the generator itself or to *any other property* of the plaintiff. Understandably, the district court concluded that the damages sought were not compensable under the doctrine of strict liability. In addition, the district court found that the plaintiff was not within the "class of consumers" entitled to relief based on strict liability. Thus, *Southwest* provides no support for the Rule 12(b)(6) dismissal below. Petitioners *are* "consumers" within the meaning of the doctrine of strict liability. *They have* unequivocally *alleged* that defendants' defective product caused physical harm or damage to their property.

The decision of the district court refers to "the burden of accidental injury caused by products", to the "accidental" or "intended" alteration of petitioners' buildings and to "the kind of accidental injury against which the doctrines of strict liability and negligence are designed to protect . . . ." See pp. 15-17 of Appendix hereto. (391 F. Supp. 971-72). This language of the district court implies that there must occur an "accident" in the sense of a sudden, harmful event or casualty. Thus, it obviously interpreted RESTATEMENT Section 402A as if it related only "to liability for [accidental] physical harm . . . caused to the . . . consumer, or to his property. . . ." None of the four states so limits the doctrine of strict liability. The word "accidental", as it appears in comment *c* of this Section of the RESTATEMENT, means "fortuitous" or "unanticipated". Neither comment *c* nor any other of the Section 402A comments justifies the inference that the word "accidental" connotes a sudden, harmful or destructive event.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Ninth Circuit.

Respectfully submitted,

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Appendix

United States District Court
District of Arizona

Filed—Mar 13 1975

Civil No. 73-562-PHX-CBR

State of Arizona, etc., et al.,
Plaintiffs,

vs.

Cook Paint and Varnish Company,
a Delaware corporation, et al.,
Defendants.

MEMORANDUM OF OPINION

On September 14, 1973, plaintiffs brought this action on behalf of themselves and on behalf of other members of a purported class[1] consisting of all commercial, industrial,

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1. In view of the Court's disposition of the plaintiffs' claims, as set forth in the final order and judgment entered on November 13, 1974, and as described in this opinion, the Court does not reach the issues concerning the appropriateness of maintaining any or all of those claims as a class action. Nonetheless, in view of the extensive briefing and argument by the parties on these issues, the Court finds it appropriate to briefly address them.

The Court has the gravest doubts about the propriety of allowing any of plaintiffs' claims to proceed as a class action under Rule 23 of the Federal Rules of Civil Procedure. With respect to Count One, it is apparent that most or all of the purported class members are "indirect purchasers" from the defendants. Thus, in addition to the individual question of amount of damages, there would be presented, with respect to each class member, the individual question of proof of injury or "impact", an essential substantive element of antitrust liability. The presence of this individual question alone would probably bar class action treatment of Count One, see *Kline et al. v. Coldwell, Banker & Co., et al.*, 508 F.2d 226, 233-235 (9th Cir. 1974); see also *City and County of Denver v. American Oil Co.*, 53 F.R.D. 620 (D.Colo. 1971), although it is by no means the only obstacle which confronts the plaintiffs in this regard.

With respect to Counts Two, Three and Four, many factors militate against maintaining these claims as a class action, two of

agricultural and governmental users of rigid polyurethane foam insulation products against five defendants, who are alleged to have manufactured and marketed these products under various trade names during the years 1965 to the filing of the action. Plaintiffs' complaint, as amended, contains four counts: count one alleges a conspiracy and combination by defendants to restrain trade in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1; count two is predicated on a theory of strict liability in tort; count three charges the defendants with negligence; and count four alleges fraudulent representation. Jurisdiction as to count one is invoked pursuant to Section 4 of the Clayton Act, 15 U.S.C. § 15, and as to counts, two, three and four pursuant to 28 U.S.C. § 1332, by virtue of diversity of citizenship.

Although plaintiffs' claims will be set forth in detail below, essentially all four counts revolve around alleged flammability characteristics of the polyurethane foam insulation products manufactured and marketed by defendants, and alleged misrepresentations concerning those characteristics.

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which should be noted at this stage. First, purported class members are almost certainly located in virtually every state. As a result, the resolution of these three claims with respect to individual class members would involve the application of state substantive tort rules which differ siginficantly in many instances and subtly in others. Second, and perhaps even more significantly, the Court is convinced that the claims of some of the unnamed class members do not meet the jurisdictional amount requirement of 28 U.S.C. § 1332. It is now beyond question that the claims of these class members must be dismissed for want of jurisdiction. See *Zahn v. International Paper Co.*, 414 U.S. 291 (1973). Further, any attempt to obviate this problem by defining the class in terms of those purported class members with claims in excess of $10,000 would raise grave and, in the Court's view, insurmountable feasibility problems. For an excellent discussion of these problems, see *Zahn v. International Paper Co.*, 53 F.R.D. 430, 433-444 (D.Vt. 1971), *aff'd.* 469 F.2d 1033 (2d Cir. 1972), *aff'd.* 414 U.S. 291 (1973).

After two pretrial conferences, at which numerous motions by various parties were heard, the Court, by order dated November 13, 1974, directed that final judgment be entered in the action. At the request of plaintiffs, count four was dismissed without prejudice as to all defendants and counts two and three were dismissed without prejudice as to two of the defendants. For the reasons developed in the opinion below, count one was dismissed with prejudice as to all defendants, and counts two and three were dismissed with prejudice as to the three remaining defendants.

Count One

In their original complaint plaintiffs enumerated some eleven purposes of the defendants' purported conspiracy and combination in restraint of trade. For purposes of analyzing the antitrust implications of this conspiracy, the most important of these alleged purposes were the following: (1) "[a]ctively misrepresenting the flammability characteristics of the product and concealing from distributors, specifiers and users the true flammability characteristics of the product, all for the purpose of restraining trade, increasing the price of the product to users and creating an artificial market for the product" and (2) "[f]ixing uniform, arbitrary and non-competitive price levels at which the product is sold". Among the alleged effects of this conspiracy were that "[p]rices of the product sold by defendant corporations to plaintiffs and others were raised, fixed, stabilized, and maintained at non-competitive levels" and that "[c]ompetition between and among defendants was restricted and suppressed and purchasers of the product including plaintiffs, have been deprived of the benefits of free and open competition." At the first pretrial conference the Court noted the ambiguity inherent in plaintiffs' theory

of antitrust liability: was the conspiracy charged a conspiracy to misrepresent the flammability characteristics of the product which had the effect of permitting the product to be sold at higher prices than would otherwise have prevailed or was it a conspiracy to establish higher prices for the product, pursuant to which defendants misrepresented its flammability characteristics? With candor much appreciated by the Court and in keeping the highest traditions of the profession, plaintiffs' counsel conceded, by letter dated September 11, 1974, that they had no evidence to support the latter formulation of the conspiracy. Accordingly, plaintiffs amended their complaint to reflect a theory which they believed the evidence would support. As amended, the complaint in the critical paragraph charges that defendants conspired to "actively misrepresent the flammability characteristics of the product and • • conceal form distributors, specifiers and users the true flammability characteristics of the product, for the purpose of restraining trade, creating an artificial demand for the product, and thereby raising and stabilizing the price of the product". Although the quoted language is not entirely free from ambiguity, in light of the plaintiffs' letter of September 11, 1974, and subsequent argument at the second pretrial conference on October 26, 1974, it is clear that the conspiracy charged is one the conscious purpose of which was the misrepresentation of flammability characteristics of polyurethane foam insulation products, and one of the effects of which was the raising and stabilizing of prices of those products. In support of their antitrust claim as reformulated, plaintiffs urge essentially two theories: first, that defendants must be deemed to have intended the natural and probable consequences of their acts, a natural and probable consequence of the misrepresentations was the raising and stabilizing of prices, and therefore a constructive purpose of the conspiracy was price fixing, a *per se* violation of Section 1 of the Sherman Act, and second, that a conspiracy to engage in cooperative false advertising is, by itself, a conspiracy in restraint of trade proscribed by Section 1 of the Sherman Act.

Turning to the first of these theories, the Court finds that it far too broadly conceives the scope of conduct which has been, or ought to be, considered price fixing. Although plaintiffs have cited several cases which they believe support their constructive price fixing theory, an analysis of the facts in those cases reveals that they are inapposite to the situation presented here. In each case an actual, as opposed to constructive, purpose of the conspiracy was to affect prices, though the means used to accomplish this objective were varied, and in some cases indirect.[2]

It might, of course, be argued, as plaintiffs eloquently urged, that the Court should break new ground by recog-

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2. The four price-fixing cases cited by plaintiffs are *United States v. Socony Vacuum Oil Co.*, 310 U.S. 150 (1939); *National Macaroni Manufacturers Association v. F.T.C.*, 345 F.2d 421 (7th Cir. 1965); *United States v. Gasoline Retailers Ass'n., Inc.*, 285 F.2d 688 (7th Cir. 1961); and *Plymouth Dealers Ass'n. of Northern California v. United States*, 279 F.2d 128 (9th Cir. 1960).

United States v. Socony Vacuum Oil Co., involved a scheme whereby certain oil companies engaged in a gasoline buying program designed to eliminate so-called "distress gasoline" from the spot tank car market. The supply of distress gasoline had been a depressing influence on the price levels in the spot tank car market and its elimination had the effect of raising the price levels in that market, which in turn resulted in a higher price in the retail market. The Court found that the buying programs "had as their direct purpose and aim the raising and maintenance of spot market prices and of prices to jobbers and consumers in the Mid-Western area • • •." 310 U.S. at 216.

In *National Macaroni Manufacturers Association v. F.T.C.*, defendants agreed to fix or establish the brands or proportion of ingredients to be used in the manufacture of macaroni products. The Federal Trade Commission found that "the agreement was intended to ward off price competition for durum wheat in short

nizing a doctrine of constructive price fixing in cases where a natural and probable effect, thought not an actual purpose, of the conspiracy or combination is to affect prices. This the Court declines to do. The range of collaborative conduct, the natural and probable consequence of which might be said to be an effect of some type on the price at which goods are sold, and thus the range of conduct embraced by such a doctrine, is almost limitless. Following the logic of plaintiffs' theory to its inexorable conclusion, all such conduct would be *per se* violative of Section 1 of the Sherman Act.

Such a result manifestly would be inconsistent with the justification for *per se* rules under Section 1. The Supreme Court has explained it thusly: "[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have

supply by lowering total industry demand to the level of the available supply." 345 F.2d at 426. The court found that substantial evidence supported this finding and approved the Commission's cease and desist order. 345 F.2d at 427.

In *United States v. Gasoline Retailers Ass'n., Inc.*, the alleged violation of Section 1 of the Sherman Act was a continuing agreement among defendants to refrain from price advertising and the giving of premiums, including trading stamps, in connection with retail sales of gasoline. The court found that "[t]he basic objective of defendants' conspiracy was the stabilization of retail gasoline prices", 285 F.2d at 691, and affirmed the defendants' conviction.

Plymouth Dealers Ass'n of Northern California v. United States involved the preparation and distribution of a fixed uniform list price by dealers marketing a particular brand of automobile for use in making pricing decisions. With respect to the use of this list the court noted that "[i]t *was* an agreed starting point; it had been agreed upon between competitors; it was in some instances in the record respected and followed; it had to do with, and had its effect upon, price", (emphasis in original), 279 F.2d at 132, and affirmed defendants' conviction.

Each of these cases contains a common element: in sustaining the finding of a price fixing conspiracy, the court found that an actual, conscious purpose of the conspiracy was to affect price in some manner. As such, they simply do not furnish support for plaintiffs' constructive purpose theory.

caused or the business excuse for their use." *Northern Pacific R. Co. v. United States,* 356 U.S. 1, 5 (1958). With respect to the application of this standard, the Supreme Court has noted that "[i]t is only after considerable experience with certain business relationships that courts classify them as *per se* violations of the Sherman Act." *United States v. Topco Associates,* 405 U.S. 596, 607-608 (1972). A classic example of such a relationship is one whose actual purpose is to affect or regulate prices. By contrast courts do not have similar experience in dealing with the myriad types of relationships, business and otherwise, a natural and probable consequence of which may be to affect prices in some manner. Indeed many such relationships could not be deemed restraints of trade, let alone unreasonable restraints of trade, within the purview of the Sherman Act.[3]

The constructive price fixing theory, therefore, is an unsuitable vehicle with which to analyze the antitrust impli-

3. *Apex Hosiery Co. v. Leader,* 310 U.S. 469 (1940), provides an excellent example of this point. The case involved a strike by a labor organization during which a manufacturing plant was occupied, much equipment and property was destroyed, the plant's operations were suspended for three months, and the shipment of many completed goods was delayed. The Supreme Court held that these facts did not establish a conspiracy in restraint of trade within the purview of the Sherman Act, 310 U.S. at 512-513, even though the Court found that a substantial amount of interstate commerce was affected, 310 U.S. at 484. Although the Court noted that "[s]o far as appears the delay of these shipments was not intended to have and had no effect on prices of hosiery in the market • • •", 310 U.S. at 501, the Court did not similarly consider certain other aspects of defendants' behavior. If the constructive purpose theory urged by plaintiffs here were an accurate statement of the law, such a consideration would have mandated a finding of Section 1 liability. A natural and probable consequence of destroying equipment and property is to increase the manufacturers' costs to cover replacement and repair. In turn a natural and probable consequence of an increase in the manufacturers' costs is an increase in the price of his goods. Thus under the constructive purpose theory, a conspiracy to destroy equipment is a price fixing conspiracy, a *per se* violation of the Sherman Act. Such a result would no doubt have surprised the Court in *Apex.* Indeed the Court there noted

cations of the conduct alleged here. Rather it must be asked, in the first instance, whether cooperative false advertising is a restraint of trade, and if so, it must further be asked whether the restraint is unreasonable. Plaintiffs' second theory of antitrust liability is predicated upon affirmative answers to both of these questions. Accordingly, the Court addresses the issue of whether cooperative false advertising is a restraint of trade within the purview of the Sherman Act.

To support their contention that cooperative false advertising is such a restraint, plaintiffs rely upon a series of cases decided under Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45.[4] The leading case of this group

that "[i]t is not seriously contended here that a conspiracy to derail and rob an interstate train, even though it were laden with 100,000 dozen pairs of stockings, necessarily would involve a violation of the Sherman Act." 310 U.S. at 486-487. Under plaintiffs' constructive purpose theory and the analysis suggested above, such a contention would be serious indeed.

The Court need not belabor this point further. It does not require a particularly fertile imagination to realize the potentially limitless scope, and therefore inappropriateness, of a constructive price fixing doctrine. The Court thus declines to establish such a doctrine in this case.

4. See, *e.g.*, *Federal Trade Commission v. Royal Milling Co.*, 288 U.S. 212 (1933); *Federal Trade Commission v. Raladam Co.*, 283 U.S. 643 (1931); *Federal Trade Commission v. Winsted Hosiery Co.*, 258 U.S. 483 (1922).

In their briefs plaintiffs have also cited, in support of their second theory of antitrust liability, several cases which suggest that a conspiracy to drive out of business, or destroy, a competitor is actionable under the antitrust laws. See, *e.g.*, *California Motor Transport v. Trucking Unlimited*, 404 U.S. 508 (1972); *Caldwell-Clements, Inc. v. Cowan Publishing Corp.*, 130 F.Supp. 326 (S.D. N.Y. 1955).

That such behavior may give rise to claims under both Sections 1 and 2 of the Sherman Act was settled by the Supreme Court in *Klors, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959). No such behavior is alleged here, however; nothing in plaintiffs' complaint, briefs or argument suggests that a purpose or effect of the instant conspiracy was to drive a competitor or a class of competitors out of business. Accordingly the cases cited are not particularly helpful in analyzing the problem presented in this case.

is *Federal Trade Commission v. Winsted Hosiery Company*, 258 U.S. 483 (1922). *Winsted* involved an action by the Federal Trade Commission against a manufacturer of underwear. This manufacturer had branded and labeled its merchandise by various terms signifying all wool when in fact none of the merchandise so labelled was all wool and some of the merchandise contained as little as ten per cent wool. The Commission found that this practice represented an unfair method of competition proscribed by Section 5 of the Federal Trade Commission Act, and the United States Supreme Court affirmed this conclusion.

Plaintiffs concede that presently the scope of conduct proscribed by Section 5 of the Federal Trade Commission Act is broader than that proscribed by Section 1 of the Sherman Act.[5] Plaintiffs contend, however, that, at the time *Winsted* was decided, the only difference in the coverage of these two provisions was the element of combination or conspiracy, a requirement for Sherman Act violations but not for those under the Federal Trade Commission Act. From this premise they argue that behavior of the type found to have occurred in *Winsted*, which is admittedly very similar to that alleged here, if coupled with a combination or conspiracy becomes a "clear cut violation" of Section 1 of the Sherman Act.

This argument is unpersuasive for two reasons. First, the conduct which occurred in *Winsted* did involve collaborative aspects which could easily have supported a finding of a combination or conspiracy if such a finding had been required. There the manufacturer did not sell directly to the public but sold to various retailers who sold to the public. It was conceded that many if not all

5. See *Federal Trade Commission v. Cement Institute*, 333 U.S. 683, 694 (1948).

of these retailers were fully aware of the deceptive labelling and used it as a means of deceiving the consuming public. Indeed one of the arguments made by the manufacturer in *Winsted* was that since it had not deceived its immediate purchasers, the retailers, it had not engaged in an unfair method of competition. In rejecting this argument, Justice Brandeis relied upon three cases, two of which explicitly described the relationship between the dishonest manufacturer who provides a retailer with a deceptive product and the retailer who uses such a product to deceive the public as one of "co-conspirators".[6] 258 U.S. at 494. Such a conspiracy would, of course, be a "vertical" rather than a "horizontal" one, as charged here. It is beyond question, however, that, at the time *Winsted* was decided, vertical conspiracies or combinations were within the ambit of Section 1 of the Sherman Act. See, *e.g., Dr. Miles Medical Co. v. Park & Sons Co.*, 220 U.S. 373 (1911). The mere presence of a purported horizontal conspiracy in the instant case cannot, therefore, *a fortiori* convert *Winsted* into authority that the conspiracy is violative of Section 1 of the Sherman Act. Indeed, since *Winsted* quickly became the leading authority for the proposition that Section 5 of the Federal Trade Commission Act proscribes a broader range of conduct than that proscribed under the Sherman Act,[7] and since *Winsted* involved facts which could have supported a finding of conspiracy *Winsted* represents much more persuasive authority for precisely the contrary conclusion.

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6. See *Coca Cola Co. v. Gay-Cola Co.*, 200 Fed. 720 (6th Cir. 1912) and *Von Mumm v. Frash*, 56 Fed. 830 (E.D.N.Y. 1893).

In *Von Mumm* the court described the relationship between manufacturer and retailer as follows: "The defendants make and sell, knowingly, the tools for fraud; and they, and the knaves who buy the tools of them, intending to use them for the fraudulent purpose for which they were constructed, are co-conspirators each guilty of the fraud perpetrated in pursuance of the intent with which the tools were made * * *." 56 Fed. at 836.

In *Coca Cola Co.* the court observed: "[I]f these reasons lead to the issuing of an injunction against one of a large number of those who commit the final tort, even more do they indicate the necessity of an injunction against one who is conspiring or co-operating to cause a large number of such torts. Accordingly, we find it recognized by this court that, in a suit for unfair competition, it is not necessary to show that the immediate purchasers were deceived as to the origin of the goods; but even if they understand that they are buying the counterfeit and not the genuine, the manufacturer of the counterfeit, will be enjoined from selling it to dealers with the purpose and expectation that it shall be used by the dealers to deceive the consumer." 200 Fed. at 722-723.

The Court need not, however, rely solely on this analysis of *Winsted,* for there is a second flaw in plaintiffs' argument based upon that case. Even if it were to be conceded that *Winsted* in no way involved a conspiracy or combination, it does not follow from the holding in that case that the type of behavior found to have occurred there, if coupled with a conspiracy constitutes a violation of Section 1 of the Sherman Act. The Sherman Act does not proscribe every conspiracy the effect of which is some restriction on, or harm to, competition. See, *e.g., Apex Hosiery Co. v. Leader,* 310 U.S. 469, 503 (1940). Rather, *it is those conspiracies where the element of collaboration itself presents a special threat to competition at which the Sherman Act aims.* Thus, though individually each competition must set a price for its goods and determine the area in which to market them, when competitors collaborate to accomplish these tasks, competition is gravely threatened if not eliminated. Conversely, though individual competitors may harm competition by each falsely advertising its product, combining with other competitors marketing the same product to engage in this practice may not alter qualitatively the harm to competition.

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7. See *Federal Trade Commission v. R. F. Keppel & Bro., Inc.*, 291 U.S. 304, 310 (1933).

Plaintiffs attempt to meet the thrust of this distinction by arguing that the conspiracy here suppressed competition among the defendants in areas where they would have competed absent their conspiracy. This assertion, however, flies in the face of common sense. The purpose of the conspiracy alleged here, in essence, was to actively conceal the true flammability characteristics of polyurethane foam insulation products. Accepting as accurate for purposes of this analysis the plaintiffs' description of the flammability characteristics, each of the defendants individually, with or without a conspiracy would have been required to conceal these flammability characteristics in order to insure the survival of its product as a marketable commodity. The assertion, then, that absent the conspiracy the defendants would have competed to reveal the actual flammability characteristics of polyurethane foam insulation products and that the conspiracy thus suppressed competition among them is simply untenable.

In sum, a careful reading of *Winsted* and an analysis of the characteristics of those conspiracies at which the Sherman Act is directed dictate the conclusion that the conspiracy alleged here is not a "conspiracy in restraint of trade" within the purview of Section 1 of the Sherman Act.

Finally, strong policy considerations militate in favor of this result. The conduct alleged here, of course, would be clearly actionable under state law as a tort of misrepresentation. If conspiracies to misrepresent, such as the instant one, are deemed conspiracies in restraint of trade under the Sherman Act, a large area of state law would be subsumed under the federal antitrust laws. The Supreme Court has indicated that this is an important consideration in determining the coverage of the Sherman Act: "The maintenance in our federal system of a proper distribution

between state and national governments of police authority and of remedies private and public for public wrongs is of far reaching importance. An intention to disturb the balance is not lightly to be imputed to Congress." *Apex Hosiery Co. v. Leader,* 310 U.S. 469, 513 (1940). The availability of proceedings under Section 5 of the Federal Trade Commission Act[8] fully vindicates any federal interest in preventing the type of conduct alleged here. It is most appropriate, therefore, to leave to state tort law the private redress of any injury suffered as a result of that conduct.

For the foregoing reasons count one of plaintiffs' complaint has been dismissed with prejudice as set forth in the final order and judgment entered November 13, 1974.

Counts Two and Three

Counts two and three of plaintiffs' complaint are predicated upon theories, respectively, of strict liability in tort and negligence. Though the theories differ significantly, for purposes of the defendants' motion to dismiss, they presented the same issue and will, therefore, be considered together.

The common question, upon which the disposition of counts two and three turns, is whether the injury allegedly suffered by plaintiffs is the type of injury which is actionable under theories of strict liability and negligence. In both counts two and three plaintiffs allege that they have been damaged as follows:

> "(a) Plaintiffs' buildings and structures have been physically altered or changed, and have incurred physical harm and damage;

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8. At the second pretrial conference on October 26, 1974, counsel for defendants represented that such an action is presently pending against members of the polyurethane foam insulation industry.

"(b) The safe use and occupancy of Plaintiffs' buildings and structures have been unreasonably restricted or prevented in that Plaintiffs cannot carry on normal activities which require or involve heat, sparks or flame, because of the extreme danger of fire to their buildings and structures caused by the installation of Defendants' defective, unreasonably dangerous and negligently manufactured product;

"(c) In order to make their commercial buildings and structures reasonably fire safe, it will be necessary for Plaintiffs to physically sever or tear Defendants' product from the interior surfaces of their buildings and structures, which will necessarily result in additional physical harm and damage to said buildings and structures;

"(d) Plaintiffs' buildings and structures have become incapable of reasonably safe habitation, use or occupancy;

"(e) The market value of Plaintiffs' buildings and structures has been diminished and their marketability impaired;

"(f) Plaintiffs' buildings and structures have become veritable firetraps and many of Plaintiffs are subject to orders or restrictions imposed by fire prevention or other local authorities limiting or wholly preventing the use and occupancy of their buildings and structures."

Although the law of some five states is potentially relevant in disposing of these counts,[9] plaintiffs have conceded that under the law of all relevant states and under the Restatement (Second) of Torts the types of injury which are actionable under theories of strict liability and negligence include physical harm to property but do not include economic loss, loss of bargain, loss of profits and the like.[10]

9. Neither side disputes that these are Arizona, California, Hawaii, Texas and Alaska.

Whether the type of damage described in plaintiffs' complaint, as set forth above, constitutes physical harm to property or instead some form of "economic loss" presents, therefore, the dispositive question here. Of the enumerated injuries only subparagraphs (a) and (c) even arguably involve physical harm to property. Upon analysis these two fail to state a claim for the appropriate type of injury.

The draftsmen of the Second Restatement of Torts noted as a primary justification for the development of strict liability for defective products, that "public policy demands that the burden of accidental injury caused by products intended for consumption be placed upon those who market them * * *."[11] In what is perhaps the leading case on the distinction between physical injury and economic loss for purposes of strict liability and negligence actions, Chief Justice Traynor of the California Supreme Court observed that "[t]he distinction that the law has drawn between

10. Both Section 402A ("Special Liability of Seller of Product for Physical Harm to User or Consumer") and Section 395 ("Negligent Manufacturer of Chattel Dangerous Unless Carefully Made") of the Restatement (Second) of Torts prescribe "liability for physical harm". With respect to the cases in the relevant states which apply these two doctrines, plaintiffs have conceded that they support the distinction between physical harm and economic loss. In plaintiffs' brief this concession was qualified by the use of the word "arguendo". This qualification, however, is without significance here; the footnote to the word reveals that its use was intended to reflect plaintiffs' belief that the better rule of law would be to allow recovery for economic loss alone under theories of strict liability and negligence. See, *e.g., Santor v. A & M Karagheusian, Inc.*, 44 N.J. 52, 207 A.2d 305 (1965). Plaintiffs, however, make no argument that this rule of law is followed in any of the relevant states; they do not dispute defendants' assertion that these states follow the contrary and majority rule exemplified by the leading case of *Seely v. White Motor Co.*, 63 Cal.2d 9, 403 P.2d 145 (1965).

11. Restatement (Second) of Torts, Section 402A, comment c (1965).

tort recovery for physical injuries and warranty recovery for economic loss is not arbitrary and does not rest on the 'luck' of one plaintiff in having an accident causing physical injury. The distinction rests, rather, on an understanding of the nature of the responsibility a manufacturer must undertake in distributing his products. He can appropriately be held liable for physical injuries caused by defects by requiring his goods to match a standard of safety defined in terms of conditions that create unreasonable risks of harm. He cannot be held for the level of performance of his products in the consumer's business unless he agrees that the product was designed to meet the consumer's demands. A consumer should not be charged at the will of the manufacturer with bearing the risk of physical injury when he buys a product on the market. He can, however, be fairly charged with the risk that the product will not match his economic expectations unless the manufacturer agrees that it will." *Seely v. White Motor Co.*, 63 Cal.2d 9, 18, 403 P.2d 145, 151 (1965).

Even accepting as true plaintiffs' allegation that the installation of defendants' product physically altered their buildings and structures, application of the foregoing principles precludes recovery here on the tort theories of negligence and strict liability. The alteration of the structures was by no means accidental, but was intended; it was not a risk to which plaintiffs were subjected, it was a certainty. The harm to plaintiffs, if any, results not from the fact of the alteration, but from the failure of the bargained for alteration to meet the plaintiffs' expectations in terms of performance.

Further, the possibility that in order to remedy the failure of the product to meet the plaintiffs' expectations, procedures may have to be employed which will damage the structures in some way does not constitute the kind of

accidental injury against which the doctrines of strict liability and negligence are designed to protect the consuming public. Rather, it represents mere possible consequential damage flowing from the failure of the product to meet expected standards of performance.[12]

For the foregoing reasons counts two and three of plaintiffs' complaint have been dismissed with prejudice against defendants The Flintkote Company, PPG Industries, Inc., and Upjohn Company as set forth in the final order and judgment entered November 13, 1974.

Dated: March 12, 1975.

Charles B. Renfrew
United States District Judge

12. For the proposition that such damages are not recoverable on a theory of strict liability, see *Southwest Forest Industries, Inc. v. Westinghouse Electric Corp.*, 422 F.2d 1013, 1020 (9th Cir. 1970). The Court of Appeals did not reach the issue of recovery for such damages under a theory of negligence since it found a valid waiver of any liability under such a theory. 422 F.2d at 1020. The court in no way intimated, however, that the result would be different under a theory of negligence; indeed, the district court had determined that "there also can be no recovery for consequential damages based upon a theory of negligence • • •." 422 F.2d at 1019.

United States Court of Appeals
For the Ninth Circuit

No. 75-1232

Filed—Aug. 20, 1976

State of Arizona, in its own behalf and on behalf of its agencies, departments, commissions and political subdivisions; Automatic Welding and Supply Corporation, an Alaska corporation; Briggs Lemon Association, a California corporation; C. W. R. Citrus Processors, Inc., an Arizona corporation; Exeter Citrus Association, a California corporation; Mupu Citrus Association, a California corporation; Saticoy Lemon Association, a California corporation; Sunmac Hawaii, Ltd., a Hawaii corporation; Sun County Citrus, Inc., an Arizona corporation; Wood Lake Packing House, a California partnership; Yerba Corporation, an Arizona corporation; and Yuma Citrus Exchange, an Arizona corporation,

Plaintiffs-Appellants,

vs.

Cook Paint and Varnish Company, a Delaware corporation; The Flintkote Company, a Massachusetts corporation; PPG Industries, Inc., a Pennsylvania corporation; Reichhold Chemicals, Inc., a Delaware corporation; and Upjohn Company, a Delaware corporation,

Defendants-Appellees.

OPINION

Appeal from the United States District Court
for the District of Arizona

Before: DUNIWAY, GOODWIN and SNEED, Circuit Judges.

PER CURIAM:

The judgment is affirmed in all respects, for the reasons stated by District Judge Renfrew in his opinion, D.C. Ariz. 1975, 391 F. Supp. 962.

At oral argument, we raised a question as to the court's jurisdiction over counts two and three of the complaint. Appellants' counsel asserted that it rests (as Judge Renfrew states, 391 F. Supp. at 965) on diversity of citizenship (28 U.S.C. § 1332). Appellees' counsel responded that the presence of the state of Arizona as plaintiff destroyed the necessary diversity. We called for memoranda on the question. Appellants' memorandum now asserts that diversity jurisdiction is lacking because of the joinder of Arizona as a plaintiff, citing *Arctic Maid v. Territory of Alaska,* 9 Cir., 1961, 297 F.2d 28, 31. *See also Fifty Associates v. Prudential Ins. Co.,* 9 Cir., 1970, 446 F.2d 1187, 1191. On the other hand, appellees assert that the presence of Arizona should not destroy the diversity jurisdiction over the claims of the other plaintiffs, because each plaintiff has a separate claim, and they are in the same case with each other and with Arizona only by reason of the liberal joinder provisions of the Federal Rules of Civil Procedure. *Caldwell-Clements, Inc. v. Cowan Publishing Corp.,* S.D.N.Y., 1955, 130 F. Supp. 326, is cited. We need not decide this question, because both sides agree—and so do we—that the court had pendent jurisdiction over counts two and three.

As appellees state:

> This present case is a textbook example of pendent jurisdiction. The claims "derive from a common nucleus of operative fact;" the basic test is that "if, considered without regard to their federal or state character, a plaintiff's claims are such that he would ordinarily be expected to try them all in one judicial

> proceeding, . . . there is power in federal courts to hear the whole." *Beverly Hills Nat. Bank & Tr. Co. v. Compania de Nav. Almirante* [9 Cir., 1971, 437 F.2d 301, 306], citing *United Mine Workers v. Gibbs* [1966], 383 U.S. 715, 725; *Astor-Honor, Inc. v. Grosett & Dunlap, Inc.*, 441 F.2d 627, [629] (2 Cir., 1971); *Rosado v. Wyman,* [1970], 397 U.S. 397. Here, the evidence necessary on Count 1 would include the evidence needed on every other count.
> (appellees' memorandum, page 10.)

The jurisdictional question is of importance only because the trial court's judgment dismisses counts two and three, as against three defendants "with prejudice," an adjudication on the merits. (See Rule 41(a) and (b), F. R. Civ. P.) If jurisdiction over the claims stated in those counts were based on diversity of citizenship, the power of the court to enter such a judgment would be clear. If jurisdiction is pendent only, then appellants can argue, as they do that,

> [i]n the event the Court's ruling on the federal antitrust claim is adverse to plaintiffs, we concede that the Court's exercise of pendent jurisdiction over the non-federal claims alleged in Counts Two and Three would not then be proper. See *Williams v. United States,* 405 F.2d 951 (9th Cir. 1969).
> (appellants' memorandum, p. 4)

Appellees do not appreciate appellants' "concession," wishing to preserve their judgment on counts two and three. We conclude that appellees are right.

Appellants cite the dictum in *United Mine Workers v. Gibbs, supra,* that "if the federal claims are dismissed before trial, even though not insubstantial in a jurisdictional sense, the state claims should be dismissed as well." 383 U.S. at 726, which we cited in *Williams v. United States,*

supra, 405 F.2d at 955. The continued viability of the *Gibbs* dictum has been questioned. *See Rosado v. Wyman, supra,* 397 U.S. at 403-05. Be that as it may, the question is one of discretion, not one of power (*id.* at 404). *See also Gibbs, supra,* 383 U.S. at 726; *Hagans v. Lavine,* 1974, 415 U.S. 528, 545-46; Note, *U.M.W. v. Gibbs and Pendent Jurisdiction,* 1968, 81 Harv. L. Rev. 657, 659-60, 664-67. We find no abuse of discretion here.

This is not a case in which the district court reached out to decide a state law issue after dismissing the federal claim. *Cf. Wham-O-Mfg. v. Paradise Mfg. Co.,* 9 Cir., 1964, 327 F.2d 748, 752-54, *cited with approval* in *Gibbs, supra,* 383 U.S. at 726 n.16. Here the court and the litigants had expended considerable time on the tort claims before the antitrust claim was dismissed. Additionally, in June, 1974, when the district court decided the negligence and strict liability questions, the antitrust claim, as then framed, stated a claim upon which relief could be granted. On June 12, the court ordered the motion to dismiss counts two and three "granted with prejudice." It was not until September that plaintiffs amended their antitrust count so that it no longer alleged a conspiracy to fix prices, but rather a conspiracy not to disclose the flammability characteristics of the product, an effect of which was to produce higher prices at which polyurethane sold. 391 F. Supp. at 965. We read *Gibbs* and *Wham-O-Mfg.* only to require district courts not to reach out to decide state law questions that need not be decided. That did not occur here. It was not an abuse of discretion for the district court to refuse to vacate the judgments on those state claims that it had already decided on their merits. *Gray v. International Assn. of Heat & Frost Insulators, Local No. 51,* 6 Cir., 1971, 447 F.2d 1118, 1120.

Affirmed.

SNEED, Circuit Judge (Concurring):

I concur in the foregoing opinion. It is necessary, however, to observe that this circuit has not in all instances denied recovery for an economic loss in actions based on negligence. *See Union Oil Co. v. Oppen,* 501 F.2d 558 (9th Cir. 1974). Judge Renfrew, however, in this case was correct in holding that the injury set forth in Counts Two and Three is the failure of the insulation purchased by the plaintiffs to meet their expectations in terms of performance. 391 F. Supp. at 971-72. Compensation for such an injury requires the existence of an undertaking by the seller that his goods will meet such expectations. A cause of action based on such an undertaking sounds in contract, not tort.

Supreme Court, U. S.
FILED
FEB 9 1977
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In the Supreme Court of the United States

No. 76-973

STATE OF ARIZONA, et al.,

Petitioners,

v.

COOK PAINT AND VARNISH COMPANY, et al.,

Respondents.

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In the Supreme Court of the United States

No. 76-973

STATE OF ARIZONA, et al.,

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v.

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Respondents.

Brief of Respondents in Opposition to Petition for Writ of Certiorari

QUESTIONS PRESENTED

The questions presented are not those proffered by the petition (at pp. 2, 3) but are these:

1. Does the common-law tort of misrepresentation of the nature and quality of a type of product become actionable under the Sherman Act by alleging a conspiracy to commit the misrepresentation?

2. Is the scope of a manufacturer's liability for injury from a product, under state common-law theories of strict liability or negligence, a question deserving review by this Court under its certiorari jurisdiction?

STATEMENT OF THE CASE

Each plaintiff claimed to own a structure in which polyurethane foam insulation for interior use against heat and cold had been installed from materials manufactured by one of the defendants. One count of plaintiffs' complaint charged that each defendant had made fraudulent representations concerning the flammability characteristics of the product. That is what the case was about. But in order to escape an adverse ruling about permission to prosecute the misrepresentation claim as a class action, plaintiffs voluntarily dismissed that count without prejudice.

That left three other counts, which dressed up the same basic grievance in other garb. In one of the three, the grievance was presented as a claim of strict liability of a manufacturer; in another count as one of negligence in manufacture. Another count sought to glue together the diverse claims of diverse plaintiffs against diverse defendants into one massive suit on behalf of all industrial, commercial, agricultural and governmental entities in the United States who have had the insulation installed, by alleging a conspiracy to misrepresent the flammability characteristics of the product, upon the supposition that the Sherman Act is implicated by alleging a conspiracy to commit the tort. Tucked away in the interstices of this count were brief boiler-plate phrases that defendants had "conspired to fix prices". But doubting that plaintiffs "really, in good faith, intend to pursue such a claim", defendants suggested that "full pretrial hearings and determinations" would be fruitful to get to the truth of the matter, pursuant to pretrial procedures established by local rule for ascertaining the real nature of claims asserted. At the subsequent extensive pretrial hearing, plaintiffs' several counsel variously phrased and rephrased their contention about what the antitrust claim was. The court stated its view that a claim of

> ". . . a conspiracy whereby the defendants got together and agreed to establish artificial prices for the sale of the product in question and, as part of the means to establish those artificial prices, misrepresented the flammability of that product, exchanged price information and engaged in a myriad of other unlawful activities in violation of Section 1 of the Sherman Act"

stated a claim under § 1 of the Sherman Act, but that a claim of

> ". . . a conspiracy on the part of the defendants to misrepresent the flammable qualities of the product and that misrepresentation has the effect of permitting the product to be sold at prices higher than it otherwise would be sold"

did not (Tr. 249). Pressing plaintiffs to state which claim, if either, they asserted, the court exclaimed that it had "a great deal of difficulty finding exactly where the plaintiffs stand" and that plaintiffs seemed to be playing Fox and Hounds in describing their claim (Tr. 250, 253-254).

Plaintiffs' counsel conceded that the claim as variously described by them in the colloquies was so different from the allegations in the complaint that they ought to file a redefinition and that the best way to do so was "a pretrial order *** to be entered by the Court perhaps after we submit our ideas in writing as to what it ought to contain" (Tr. 281). The court so ordered. Three months later plaintiffs' counsel wrote to the court explaining their delay in complying with the order by stating (R. 331):

> ". . . I realized that I had accepted a description of our Sherman Act claim which, upon further review with my colleagues of the presently available evidence, I believe cannot be proven. The description to which I refer is 'a conspiracy whereby the defendants got together and agreed to establish artificial prices for the sale of the product in question and, as part of the means to establish those artificial prices, misrepresented the flammability of that product, exchanged price information and engaged in a myriad of other unlawful activities in violation of Section 1 of the Sherman Act'.

> "While it would obviously have been relatively simple to use this statement of the nature of the conspiracy as the nucleus of a proposed pretrial order we have concluded that it would be a disservice to the Court and counsel to do so in the face of what appears to be a paucity of hard evidence to support the claim in that form. In consequence, we have decided to 'bite the bullet' and restate our Sherman Act claim in a manner consistent with our understanding of the evidence."

To this end the letter enclosed a proposed pretrial order (R. 391), which restated the claim in the form of radical amendment of the crucial paragraphs of the original complaint. In the original complaint plaintiffs had alleged that one of the things defendants had agreed or conspired to do was "fixing uniform, arbitrary and non-competitive price levels at which the product is sold", and there were other references to a conspiracy to "fix prices" and to meetings to exchange prices (R. 15, 16, 17). The redefinition abandoned all these price-fixing allegations. The description of the claim was now confined to an agreement or conspiracy to do a number of items, all of which were to misrepresent or conceal flammability characteristics of the product. One of the allegations of the original complaint had been that defendants conspired to misrepresent the flammability characteristics "all for the purpose of restraining trade, increasing the price of the product to users and creating an artificial market for the product." (R. 15). In the redefinition, this was recast so that increasing and fixing prices was no longer alleged to be a purpose.

Defendants thereupon moved to dismiss the so-called antitrust count, as not one of a wrong actionable under the Sherman Act, and based the motion "upon the whole record", i.e., not merely upon the amended pleading but on all the "judicial admissions" (IX Wigmore on Evidence (3rd ed.) Tit. II, Judicial Admissions; *Oscanyan v. Arms Co.*, 103 U.S. 261 (1881)). The motion was granted.

The state law counts were also ordered dismissed as alleging no claim for relief under applicable state law. From the judgment plaintiffs appealed, the court below affirmed, and the petition followed.

DISCUSSION

A. As Respects the So-Called Sherman Act Count.

The petition dwells on the elementary citations about price fixing, but this is not a price-fixing case. The question was whether plaintiffs can use the machinery of federal law and federal courts to recover treble damages for a common-law fraud, and whether the use of conventional antitrust language can convert what is basically fraud in business transactions into antitrust. And bearing in mind that, if conduct is civilly actionable under the Sherman Act, it is also a crime, the question is whether the actionable state law tort of misrepresentation becomes a federal crime because committed by conspiracy whose only purpose is to misrepresent.

"A plaintiff cannot, by charging a conspiracy, turn what is basically a claim of violation of state law into a federal antitrust case." *Sun Valley Disposal Co., Inc., v. Silver State Disposal Co., et al.*, 420 F.2d 341, 343 (9 Cir. 1969). Numerous decisions have said the same thing in similar words, about fraud, misrepresentations, acts of unfair competition, and a variety of business torts. In various ways they have said that the antitrust law is not a panacea for all ills that befall citizens because damage is caused by business. For example: *Craig v. Sun Oil Co.*, 515 F.2d 221 (10 Cir. 1975); *Ace Beer Distributors, Inc. v. Kohn, Inc.*, 318 F.2d 283 (6 Cir. 1963), *cert. denied*, 375 U.S. 922; *Norville v. Globe Oil & Refining Co.*, 303 F.2d 281 (7 Cir. 1962); *Parmelee Transportation Co. v. Keeshin*, 292 F.2d 794 (7 Cir. 1961), *cert. denied*, 368 U.S. 944; *George R. Whitten, Jr., Inc. v. Paddock Pool Builders, Inc.*, 508 F.2d 547 (1 Cir. 1974) *cert. denied*, 421 U.S. 1004 (1975), *B & B Oil & Chemical Co. v. Franklin Oil Corp.*, 293

F.Supp. 1313 (E.D.Mich. 1968); *Searer v. West Michigan Telecasters,* 381 F.Supp. 634 (W.D.Mich. 1974), aff'd. 524 F.2d 1406 (6 Cir. 1975); *W. T. Grant Co. v. Christensen,* 1975 Trade Cas. ¶ 60,324 (S.D.N.Y. May 1975), aff'd. 531 F.2d 671 (2 Cir. 1976); *Kemp Pontiac-Cadillac Inc. v. Hartford Automobile Dealers Ass'n.,* 380 F.Supp. 1382, 1388, fn. 8 (D.Conn. 1974); *Tower Tire & Auto Center, Inc. v. Atlantic Richfield Co.,* 392 F.Supp. 1098 (S.D.Tex. 1975); *In re Multidistrict Vehicle Air Pollution,* 367 F.Supp. 1298 (C.D. Cal. 1973), aff'd. 538 F.2d 231 (9 Cir. 1976)

The means by which petitioners try to convert an alleged conspiracy to defraud by misrepresentations into a price-fixing conspiracy is to argue that but for the misrepresentation consumers would either not buy the product at all or would pay less for it; ergo, price is affected upward from zero or from a lower to a higher price. Outside of a Communist country—possibly even there—anything in any economic situation sooner or later is reflected in price; imagination can therefore always find "price" somewhere in an analysis. Thus every successful strike for higher wages affects costs and by "cost-push" inflation affects prices. But *Apex Hosiery Co. v. Leader,* 310 U.S. 469 (1940) taught that these things are not the effect on price with which the antitrust laws concern themselves. Both *Apex* and *Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc.,* 365 U.S. 127 (1961) made clear that what the Sherman Act denounces is not conspiracy or conspiracy having "a commercial impact," but only a particular kind of conspiracy, one in "restraint of trade". *Noerr* stated that insofar as the Sherman Act proscribes "unethical" business conduct, it is only a condemnation of "trade restraints" (pp. 140, 141).

Antecedent in any antitrust analysis to any other question, such as whether a "restraint" is illegal *per se,* is the basic one whether the activity challenged is a "restraint of trade" at all. The words "restraint of trade" are not the equivalent of impediments to or

distortions of trade. They are words of art, whose meaning is derived from history and is confined to that historical meaning. At common law, "restraints" were but one of a variety of condemned conduct, and misrepresentations and fraud in the sale of goods were quite another traditional heading of common law. State law has always been fully capable of protecting against them and has long denounced them. Fraud and misrepresentation were known at common law, were not thought of as restraints of trade, and are no more a basis for a Sherman Act case when applied to a new product, polyurethane, than when applied to a horse trader.* In *Hunt v. Crumboch,* 325 U.S. 821, 826 (1945), this Court said:

> "That Act [Sherman] does not purport to afford remedies for all torts committed by or against persons engaged in interstate commerce. 'The maintenance in our federal system of a proper distribution between state and national governments of police authority and of remedies private and public for public wrongs is of far-reaching importance. An intention to disturb the balance is not lightly to be imputed to Congress.' *Apex Hosiery Co. v. Leader,* 310 U.S. 469, 513. Whether the respondents' conduct amounts to an actionable wrong subjecting them to liability for damages under Pennsylvania law is not our concern."

A basic vice in petitioners' argument is that it is oblivious to the elementary difference between *restraining* and *inducing.* Webster defines "restrain" as "to hold back, to check, either by physical or moral force or by an interposing obstacle, to suppress, or to curb." "Induce" is defined as "to lead on, to influence, to prevail on, to move by persuasion or influence". The distinction is the same fundamental difference as exists between "fraud" and "coercion". Upon exactly this fundamental distinction the federal

*David Harum is the traditional figure of a horsetrader in the United States. But it is impossible to imagine an indictment in 1892 under the Sherman Act against David Harum and other horsetraders in upstate New York for conspiracy to misrepresent the quality of their horses.

mail fraud statute does not reach the use of the mails to coerce. *Fasulo v. United States,* 272 U.S. 620 (1926). The distinction runs throughout the law. Coercion, restraint, overpower the will, deny or foreclose to one what he wishes, while fraud leads one to will what the fraud-feasor desires. "Restraint" means conduct that deprives or is intended to deprive those in the target area of the power of choice because the "crux of any price-fixing agreement is the relinquishment by a trader * * * of the freedom to set prices in accordance with his own judgment", *Chisholm Bros. Farm Equipment Co. v. International Harvester Co.,* 498 F.2d 1137, 1142 (9 Cir. 1974), cert. denied, 419 U.S. 1023. To the same effect, *Checker Motors Corp. v. Chrysler Corp.,* 283 F.Supp. 876, 882 (S.D.N.Y. 1968), aff'd., 405 F.2d 319 (2 Cir. 1969). "Fraud" is a different species of wrongdoing; it does not deprive one of choice; it induces choice.

The petition also contends that defendants conspired not to compete against each other in representations as to relative freedom from flammability hazards, but that contention was first made in a reply brief in the Court of Appeals. There was never a claim in the complaint or in the district court that the polyurethanes of the several defendants were different, or that some were less fire hazardous than others. They were all charged as a fungible chemical, and it was polyurethane against the world, not a situation of intra-defendant variability.

B. The State Law Claims.

The issue here is what kind of claims are redressable under doctrines of strict liability and negligence. That issue is a question of state law, here the laws of California, Arizona, Hawaii and Alaska. The district judge and the three judges of the panel of the Court of Appeals, residents of the area and trained in its laws, have construed the applicable state law as not reaching the kind of injuries claimed by plaintiffs. Whether these four judges, familiar with the common-law of these states, are right

or wrong is not the kind of question to which this Court should apportion any of its limited time.

Plaintiffs try to insinuate some kind of federal question into this state law subject by constructing a procedural question of pleading. The gist of this argument is that state law permits recovery for "physical harm", that the complaint as amended contained the label "physical harm", and that therefore the district court ignored the pleading. But what the district court did was to hold that *the type of injury asserted,* by whatever conclusory words it was labeled, was not a type redressable under applicable state law. The court reached its decision only after an extensive discussion in open court, wherein plaintiffs' counsel had said to the court:

> "I want to tell you what our case is about so we can make the magic words in the complaint match what I am saying"

to which the court responded:

> "THE COURT: Well, the question we have before us we shouldn't think of as magic words of the complaint, what we are trying to find out is the actual nature of the injury of which you complain. ***
>
> All right. Now, what is the injury to [sic] damage here that you claim?" (Tr. pp. 97, 98).

After explaining in full the alleged injuries, plaintiffs asked leave to amend the complaint to label the injuries as "physical harm", and the court responded:

> "THE COURT: I wouldn't have any objection to that, if you would like to do that. What we are really talking about in that count was the argument and the theory which you so eloquently advanced yesterday. *** But I really feel the legal question has been squarely put before me." (Tr. 265-266)

It then decided the state law question, going to the substance. The sole issue is the scope of state law, not niceties of pleading.

CONCLUSION

We respectfully submit that the petition should be denied.

Dated: San Francisco, California, February 8, 1977.

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